



PROMOTING A CUSTOMER FOCUS

JULY 2021

**Response to IPART's Discussion Paper 2
Regulating Water Businesses Special Review**



Acknowledgement of Country

Hunter Water operates across the traditional country of the Awabakal, Birpai, Darkinjung, Wonaruah and Worimi peoples. We recognise and respect their cultural heritage, beliefs and continuing relationship with the land, and acknowledge and pay respect to Elders past, present and future.

Mariin Kaling - All for Water

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Saretta

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KEY MESSAGES

Hunter Water welcomes IPART's Discussion Paper and preliminary positions on promoting a customer focus. The paper provides an excellent summary of current arrangements, alternative models and key issues.

Hunter Water endorses IPART's principles-based approach. We acknowledge and accept the responsibility of understanding customer views and values. Our job is to reflect customer preferences in our business decision making. We must be able to assure our customers, IPART and others that we do that well.

 IPART's preliminary position	Our assessment	 Comment
<p>The water businesses should remain responsible for understanding their customers' views, priorities and needs</p>		<p>We agree with IPART that water businesses are best placed to engage with, and learn from, their customers. We acknowledge the responsibility to reflect customer insights and feedback in our strategic, planning and operational decisions.</p>
<p>Our guidance around customer engagement will remain principles-based</p>		<p>We support IPART's principles-based approach: the existing and additional principles. IPART does not seek to prescribe methods or practices. We would welcome an early check-in with IPART on our customer engagement plan.</p>
<p>Customer advisory or challenge groups need to clearly support customer outcomes</p>		<p>We are considering the benefits of a single-purpose customer advisory group. We may also use customer advocates and customer engagement professionals to help guide our next regulatory proposal.</p>
<p>Customer outcomes would clarify how the efficiency test considers customer preferences and service levels</p>		<p>We support a framework that links expenditure, outputs and outcomes with customer values and preferences.</p> <p>IPART should provide clear expectations and guidance, potentially with training and support for business to adopt the new approach.</p>
<p>The role of our discretionary expenditure framework is less clear.</p>		<p>We support a balanced approach that recognises the often non-binary nature of expenditure drivers. In the majority of cases, there should be better integration of expenditure review frameworks.</p>

1. PUTTING CUSTOMER AT THE CENTRE OF WHAT WE DO

IPART's Discussion Paper proposes a set of principles to promote the long-term interests of customers and a grading system to evaluate how well a business's pricing proposal meets those principles. IPART also suggests the resultant grading system be tied to reputational, administrative, and financial incentives - both rewards and penalties.

IPART's position is consistent with the current conventional approach of other economic regulators, where:

- regulated businesses are responsible for designing and conducting their own customer engagement
- the regulatory framework establishes incentives for high quality proposals, customer engagement and performance.

Hunter Water supports IPART's proposed approach, noting a regulatory framework to guide and reward good customer engagement would:

- recognise that water businesses should remain responsible for understanding their customers' needs and preferences, and the best way to engage with their customers
- establish principles for sound and effective customer engagement rather than prescriptive requirements
- focus on providing clear, symmetric and proportionate incentives for engagement rather than mandating requirements
- tie engagement to improving customer outcomes and satisfaction rather than being required for its own sake.

In the sections below, we provide an overview of the incentive regimes of other economic regulators and our proposed principles for promoting the long-term interests of customers. We offer suggestions for how IPART's process could be refined to provide stronger incentives for high quality customer engagement and pricing proposals.

1.1. Economic regulation

Economic regulators, including the ESC, Ofwat and Ofgem, have introduced grading systems tied to various forms of reputational, administrative and financial incentives. Reputational incentives relate to publicly reporting on the performance of the businesses and quality of its pricing proposal. Administrative incentives include 'fast tracking' the price review process to provide earlier certainty and a proportionate review of the business's proposal (eg, lighter-handed expenditure review). Financial incentives include increases in the return on equity, separate adjustments to the revenue allowance for higher/lower levels of performance and/or changes to cost sharing arrangements between businesses and customers.

These incentive regimes are aimed at replicating the effects of a competitive market, whereby the businesses' price and quality (service level) offerings must reflect a strong understanding of their customers to retain and expand market share. The regimes encourage businesses to innovate, be more efficient and deliver better outcomes for customers now and into the future, and are supported by high-quality explanation and information. They are also aimed at providing businesses with an incentive to 'put their best foot forward' from the outset, rather than wait for the regulator to conduct detailed review and analysis of their proposal.

Both the ESC and Ofwat refer to the level of 'ambition' in a pricing proposal. The implication being that if a regulated business's plan sought to replicate the outcomes of competition upfront, rather than rely on the regulator to do this through its own detailed review, then this would be recognised and rewarded.

According to the ESC:

"The ambition of a price submission reflects the extent to which a water business has challenged itself to meet all of its statutory and regulatory objectives while delivering the outcomes and prices customer value. ... A more ambitious price submission will propose targeted services and outcomes at lower prices, for example.

This is achieved through better customer engagement, efficient management practices and rigorous self-examination.”¹

Ofwat noted that it wanted businesses to produce high quality, ambitious and innovative business plans:

“An ambitious business plan pushes forward the efficiency and delivery frontier for the sector, setting a new standard for the future and benefitting all customers as a result. Ambition could mean significantly reducing cost and improving efficiency beyond the frontier for the sector, or significantly improving service for customers beyond the established frontier for the sector at efficient cost. Another example of ambition may be where a company’s plan demonstrates a clear understanding of the risks facing service delivery, complemented with an exceptional approach for managing and mitigating those risks in a cost-efficient way.”²

CEPA’s summary report for IPART on frontiers of economic regulation observed:

- reputational incentives are used for all company ownership types. Regulators of state-owned utilities have focused more on reputational incentives, although financial incentives are still used.
- benchmarking and being able to compare businesses’ performance is considered important where financial incentives are applied. Benchmarking relies on a large number of businesses with similar scope, scale and operating contexts. This is not the prevailing circumstance in the price-regulated NSW water sector.
- there has been a move to simplify incentives, moving away from complex mathematical formulas, to improve clarity.
- most regulators apply proportionate or risk-based reviews – ie, where the level of regulator review and intervention is inversely related to the quality of the proposal (particularly the quality of customer engagement). The objective of this approach is to focus regulatory effort on issues or businesses where risks of impact to customers are highest or where there is evidence of underperformance, and to provide an incentive for high quality pricing proposals.³

CEPA notes that the use of reputational incentives, early in the process, to publicise positive and negative aspects of businesses’ proposals appears to be an effective and low-cost approach to incentivise better performance, particularly when there is extensive customer engagement.⁴

1.2. Promoting the long-term interests of customers

Conceptually, the long-term interest of customers is best promoted when performance and outcomes replicate, to the extent possible, those of a competitive market. In practice, this occurs when regulated businesses strive to understand their customers’ preferences, innovate and find ways to be more productive, and deliver the services their customers want – in terms of quality, reliability, sustainability and security of supply – at the lowest possible prices.

Hunter Water considers that there are a number of desirable features of the ESC’s PREMO model and the criteria for assessing water business’s pricing proposals:

- Performance – have the performance outcomes to which the business committed in its price submission been met or exceeded?
- Risk – has the business sought to allocate risk to the party best positioned to manage that risk?
- Engagement – how effective was the business’s customer engagement?
- Management – is there a strong focus on efficiency? Are controllable costs increasing, staying the same, or decreasing?
- Outcomes – do proposed service outcomes represent an improvement, the status quo, or a withdrawal of service standards?⁵

¹ Essential Services Commission, Water Pricing Framework and Approach, Implementing PREMO for 2018, October 2016, p 9.

² Ofwat, Delivering Water 2020: Our final methodology for the 2019 price review, December 2019, p 240.

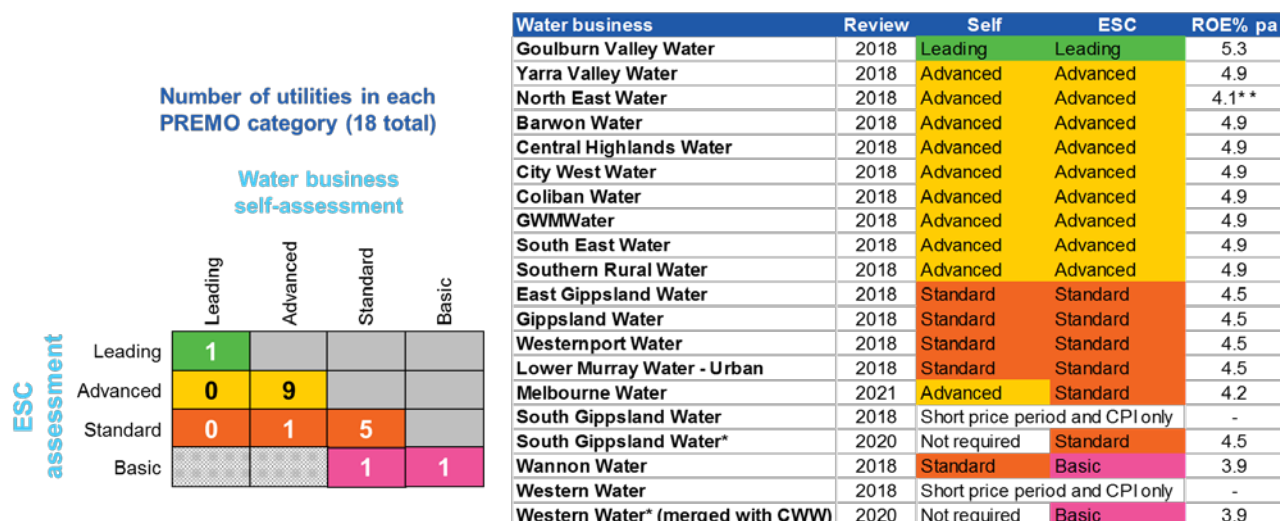
³ CEPA, Economic Regulation of Water Utilities – Research, Final Report for IPART, 30 June 2020, p 7.

⁴ CEPA, Economic Regulation of Water Utilities – Research, Final Report for IPART, 30 June 2020, pp 32-36.

⁵ Essential Services Commission, Water Pricing Framework and Approach, Implementing PREMO for 2018, October 2016, p 10.

The PREMO model appears to have been successful in incentivising water businesses to 'put their best foot forward', as evidenced by the consistency between self-ratings and ESC ratings (see Figure 1.1). It also lifted customer engagement quality across the sector, with many water businesses rated highest in the 'Engagement' aspect of PREMO.

Figure 1.1 ESC PREMO grading of proposals in 2018 and 2021 price reviews



Note: North East Water could have received a return on equity (ROE) of 4.9% pa but was granted the 4.1% they requested.

Ofwat's 2019 price review assessed companies' business plans and pricing proposals against a number of test areas: engaging with and delivering outcomes for customers, long-term resilience, aligning risk and return, innovation and cost-efficiency.⁶

Ofwat provided guidance on what constituted a high-quality business plan:

- evidence of excellent customer engagement, including stretch outcomes and performance commitments that reflect what customers want
- cost efficiency
- effective risk management
- innovation for the benefit of customers and the environment
- affordability for current and future customers
- compliance with licence and statutory obligations
- consistent, accurate and assured cost and price information
- operational, financial and corporate resilience over the long-term, and
- an understanding of the drivers of its performance, including any lessons learnt from past performance.⁷

Ofwat's 2017 final methodology for the 2019 price review detailed the various categories of grades and the associated procedural and financial incentives (see Figure 1.2).

⁶ Ofwat, Delivering Water 2020: Our final methodology for the 2019 price review, December 2019, page 239.

⁷ There were nine test areas in total: • engaging customers; • addressing affordability and vulnerability; • delivering outcomes for customers; • securing long-term resilience; • targeted controls, markets and innovation; • securing cost efficiency; • aligning risk and return; • accounting for past delivery; and • securing confidence and assurance.

Figure 1.2 Ofwat grading of proposals in the 2019 price review

Reputational	Procedural incentives	Financial incentives
Exceptional		
Published performance relative to peers and public recognition	Early draft determination (March or April 2019) with early certainty principle applied to specified component of costs and outcomes. Companies can opt out of the early certainty principle.	An amount equivalent to a 20 basis points (bp) to 35bp addition to the return on regulated equity (RoRE) over the whole price review period, based on the notional gearing of 60%. Standard cost sharing rates.
Fast track		
Published performance relative to peers	Early draft determination (March or April 2019) with early certainty principle applied to specified component of costs and outcomes. Companies can opt out of the early certainty principle.	An amount equivalent to a 10 basis points (bps) addition to the return on regulated equity (RoRE) over the whole price review period, based on the notional gearing of 60%. Standard cost sharing rates.
Slow track		
Published performance relative to peers	Draft determination in July 2019. Business plans will require a level of material intervention to protect the interests of customers. These companies may be required to resubmit some of their business plans or to provide additional evidence.	Standard cost sharing rates.
Significant scrutiny		
Published performance relative to peers	Draft determination in July 2019. Business plans will require extensive material intervention to protect the interests of customers. These companies may need to substantially rework their plans. Companies whose plans fall into this category will require increased ongoing regulatory scrutiny and assurance. We may put extra measures in place to protect customers from risks associated with poor business planning. These companies may also be subject to strengthened reporting requirements.	Reduced cost sharing rates. Companies will share only 25% of cost outperformance and bear 75% of cost underperformance Potential cap on ODI outperformance payments.

Source: Ofwat, *Delivering Water 2020: Our final methodology for the 2019 price review*, December 2019, p 248.

1.2.1. Proposed assessment criteria

Drawing on approaches applied elsewhere, Hunter Water proposes the following principles for assessing whether a business's regulatory proposal – expenditure, service levels and prices – promotes the long-term interests of customers:

- a strong and continuing understanding of what customers want and their level of satisfaction with price and service outcomes
- efficient compliance with all operating licence and other regulatory requirements
- a focus on continuing innovation to reduce costs and improve outcomes for customers over time
- a long-term, strategic view of the levels of capital and operating expenditure needed to efficiently supply services at required standards over time, and recovery of this efficient expenditure
- best practice risk management, including allocation of risk to the party best able to manage that risk.

1.2.2. Guidance material

We also propose that IPART issues guidance material to explain how it will assess the water businesses' proposals against these, or similar, criteria.

In our submission in response to IPART's Discussion Paper on Lifting Performance we outlined the benefits of IPART providing greater upfront clarity around how it will assess the efficiency of businesses' expenditure proposals. We see similar value in upfront guidance and clarity around how IPART would assess other key criterion listed above – including, for example, the quality of a business's customer engagement.

We note there is a difference between providing clarity around how a regulator will assess a business's performance against a criterion and prescribing what a business should do. We consider this distinction is particularly important for customer engagement, where the regulator can provide guidance to the business about its expectations and how it might assess the business's performance, but should not prescribe specifically how the business should engage with its customers.

Prior to the 2019 price reviews, Ofwat issued guidance on its overarching principles for customer engagement, roles and responsibilities, and how it would take account of customer views when assessing businesses' pricing proposals. However, it did not prescribe in detail how companies should engage with their customers.⁸ Similarly, although it published key principles for good customer engagement which formed the basis of its assessment of businesses' pricing proposals, the ESC has said that it will not prescribe the manner in which water businesses engage with their customers.⁹

1.3. Grading regulatory proposals

Once IPART has established principles, criteria and supporting guidance material, it would apply a framework that provides reputational and administrative incentives for businesses to focus on their customers and submit high quality pricing proposals.

We propose a framework whereby IPART would:

- first conduct an assessment and grading of each business's pricing proposal against the assessment criteria in a way that is consistent with its guidance material. IPART would publicly report its assessment.
- ensure that subsequent elements of its price review process, including its expenditure review and decisions as to whether or not to accept or change elements of a business's pricing proposal, are proportionate to the quality of that proposal. This should mean that higher quality pricing proposals are subject to a streamlined, targeted review after the initial assessment or grading; whereas lower quality proposals would be subject to more detailed and intensive review by IPART.

Hunter Water considers this framework offers three main benefits:

1. Makes businesses accountable for the quality of regulatory proposals, and encourages ongoing improvements at each price review.
2. Improves transparency and clarity around IPART's expectations and its assessment of what constitutes a high-quality submission. By doing so, this would subject IPART's approach to greater scrutiny over time and promote improvements to its methodologies where warranted.
3. IPART does not have multiple businesses to benchmark or compare at any one time. Nevertheless, there can still be benefits from the reputational incentives and shared learnings generated from IPART publicly reporting on its assessment of the quality of a business's pricing proposal.

In the first instance, we propose that IPART's framework focus on reputational and administrative incentives: published grading of regulatory proposals, and targeted, less intrusive IPART expenditure reviews. Over time, once further developed and tested, IPART could consider adding financial incentives.

⁸ Ofwat, 2016, Ofwat's customer engagement policy statement and expectations for PR19, May, page 4.

⁹ Essential Services Commission, 2016, Water Pricing Framework and Approach, Implementing PREMO for 2018, October, pages 15 to 16.

2. IPART'S PRINCIPLES AND GUIDANCE

Hunter Water supports IPART principles-based approach to setting its expectations for customer engagement. This gives each water business the flexibility to tailor engagement activities to suit its operating context.

We support IPART's additional three principles. These reflect best-practice customer engagement across Australia and the United Kingdom, aimed at encouraging water businesses evolve and mature their customer engagement practices and demonstrate the link to business decision making.

Over past reviews, IPART has used the principles to delineate the acceptable from unacceptable, with IPART's feedback during pricing reviews focussed on "*where we found customer consultation was insufficient*" and limited guidance has been provided on improvement opportunities.¹⁰

We are pleased to see recognition that "*the quality of customer engagement is non-binary*".¹¹ As discussed earlier, we would encourage IPART to more clearly set out how the principles could be used to delineate 'good' from 'satisfactory' customer engagement along the quality spectrum.

2.1. Current customer engagement principles

IPART's current principles remain relevant and sensible:

- objective
- relevant
- proportionate
- representative
- clearly communicated and accurate.

We offer comments on the challenges of interpreting and applying the latter three principles.

2.1.1. Proportionate

It makes sense that the "*engagement is proportionate to the potential impact on service and/or price*" so that the resourcing cost of the engagement does not outweigh the potential benefit of the service being consulted on.¹² We would welcome written guidance with some practical examples.

For instance, is it acceptable to justify improvements to customer interfaces, like e-billing, online self-serve customer portals or online development tracking, by demonstrating that we are simply 'meeting the market'? That is, demonstrating a similar service offering by energy retailers, telecommunications, water businesses in other Australian jurisdictions. IPART could usefully give examples of the type and level of customer engagement

2.1.2. Representative

Hunter Water recognises that the gold standard for customer engagement involves a statistically significant, randomly selected, sample of potentially affected customers with socio-demographic characteristics reflective of the population. There are circumstances in which this is entirely appropriate. However, it has downsides:

- creates barriers to more innovative customer research techniques like deliberative groups, effectively only 'allowing' surveys
- excludes particular customer segments that we find difficult to recruit, notably business customers
- excludes 'renters' who are impacted by investment decisions.

¹⁰ IPART, 2021, Promoting a customer focus: Discussion Paper, Special Review, June, page 8.

¹¹ Ibid, page 9.

¹² Ibid, page 17.

Depending on the project or service, Hunter Water sees merit in multiple lines of evidence, giving an opportunity to triangulate, iterate and test acceptability.

We have been concerned that IPART would consider deliberative-type approaches alone as inconsistent with their customer engagement principle of representativeness.¹³ IPART has previously disregarded Hunter Water's customer survey results due to a lack of representativeness.¹⁴

We find it challenging to undertake representative engagement with non-residential customers. In particular, finding the person responsible for water and wastewater bills at each business.

- In 2018, we did not include business customers in our willingness to pay survey due to concerns we would be unable to reach the appropriate representative within each business.
- In 2019, we achieved a sample of 51 non-residential completions of our water and wastewater pricing structures survey, despite a concerted effort to recruit through multiple channels. We sent 4,000 emails to a sample of businesses with an address in our area of operations from the Australian Business Register and achieved 49 survey completions. Online advertising on Hunter Water's website, Newcastle Herald, Hunter Business Review and LinkedIn achieved an additional two completions from more than 1,000 online impressions.
- In 2021, we have achieved a sample of 65 non-residential completions for our willingness to pay surveys to inform a review of system performance standards – 62 through online panels and only three through email invitations directly to existing contacts for larger businesses and via associations and industry bodies for small-medium enterprises.

Past feedback from IPART in relation to the difficulty Hunter Water faces in sampling non-residential customers for surveys has been to acknowledge the challenge and state that it's "*not insurmountable*".¹⁵ We would like to work with IPART on acceptable sampling options and engagement techniques for business customers.

We are aware that other water utilities have engaged with the non-residential sector through focus groups, in-depth interviews and other deliberative-type approaches. Sometimes this has been supplemented through quantitative surveys with samples drawn from reputable online survey panels, but we do not have business-based customer panels in our region.

Over the last decade we have observed an increasing expectation of universal and inclusive engagement, providing opportunities for customers, the community and other stakeholders to 'opt in' whenever possible. We are mindful that the results of 'opt in' customer research must be analysed separately to control for bias. Nonetheless, we do recognise the value in of such opportunities in building legitimacy and helping us understand the full spectrum of views including divergences from the 'constructive middle'.

2.1.3. Clearly communicated and accurate

We support the intent of this principle, which bolsters the principle of objectivity and requires water businesses to provide feedback on the findings of customer engagement. This includes explaining how customer feedback informs business in decision making.

Water businesses face the challenge of how to manage to frame cumulative impacts on services and bills.¹⁶ As IPART is aware, there are many variables that influence prices and bills, such as regulatory asset lives, WACC and price structures. There is a tension between engaging with customers earlier in developing business plans, and the level of certainty or precision that can be provided in estimated bill impacts.

We agree it is important for both customers and water businesses to maintain a focus on any potential trade-offs between service and price. We would like to continue to work with IPART on ways of presenting cumulative bill impact information whilst scheduling customer engagement activities when they can best inform decision-making and avoiding spurious accuracy.

¹³ IPART's November 2018 Guidelines for Water Agency Pricing Submissions describes the characteristics of representative surveys.

¹⁴ See IPART, 2013, Hunter Water Corporation's water, sewerage, stormwater drainage and other services: Review of prices from 1 July 2013 to 30 June 2017, Final Report, p 35.

¹⁵ IPART, 2020, Review of prices for Hunter Water Corporation from 1 July 2020, Final Report, June, page 133.

¹⁶ Ibid, page 17.

3. CUSTOMER REPRESENTATIVE GROUPS

Hunter Water supports IPART's preliminary position favouring a principles-based approach for effective customer engagement. This approach places the onus on the regulated utility to do genuine and meaningful customer engagement, and to reflect insights and feedback in strategic, planning and operational decisions.

As a monopoly supplier of water and wastewater services, Hunter Water acknowledges it has an obligation to know the views and preferences of customers across the Lower Hunter. We take this responsibility seriously, and we endeavour to do our best to engage and learn from our customers.

Hunter Water recognises that the economic regulator will look for checks and balances to ensure high quality customer engagement work and business decision making. IPART needs a level of assurance that what the utility says it does is matched by deeds and actions. Importantly, we need to demonstrate how customer engagement work feeds into service levels and expenditure plans in our pricing proposal.

IPART's Discussion Paper canvasses the various models for establishing customer groups or panels in the water and energy sectors. IPART asks whether these groups could promote a better understanding of customer preferences and better regulatory proposals.

Hunter Water's operating licence includes a clause to establish and maintain a customer advisory group; the Customer and Community Advisory Group, as recommended by IPART during earlier operating licence reviews. Hunter Water also has recent experience with establishing a community liaison group to help guide and inform the development of the next Lower Hunter Water Security Plan.

The following section discusses the merits of different customer representation models, reflects on Hunter Water's experience with the customer advisory group and identifies timing conflicts with the current schedule of reviews. At the end, we set out our current thinking about a preferred approach.

3.1. Customer representation models

IPART's Discussion Paper describes the various trials of customer negotiation and settlement in Australia and Scotland – the customer forum model. The table below shows the spectrum of customer representation models in Australia and the UK.

Table 3.1 **Customer representation models**

Model	Features	Examples
1. Operating licence stakeholder advisory group	Existing stakeholder group	Hunter Water's Customer and Community Advisory Group
2. Panel of customer engagement specialists	Market research and engagement professionals. Advise the utility on best-practice engagement techniques	
3. Utility customer advisory or deliberative group	Utility establishes an advisory group or customer deliberative forum; one-off regulatory proposal or ongoing	Most Australian electricity network businesses, UK water utilities
4. Jurisdictional challenge panel	Regulator establishes challenge group to provide advice on the quality of regulatory proposals from all regulated utilities	AER Consumer Challenge Panel, ESCOSA Consumer Experts Panel
5. Negotiated settlement group	Negotiates expenditure and service level outcomes, reports to regulator	Ausnet, Scottish Water, SA Water

Source: Hunter Water based on IPART, 2020, Promoting a customer focus, Discussion paper, Special Review, June, pages 7 to 12.

Hunter Water makes two observations about the different models:

1. Lead times: the further down the list you go, the longer the period necessary to establish, inform, educate and finalise the work of each group – in the order of a few months for an existing group to 18 months or more for a negotiation group.
2. Resourcing: the further down the list you go, the greater the cost in terms of people's time, administration, preparing supporting information and consultancy work.

3.2. Hunter Water's customer advisory group

IPART's Discussion Paper invites feedback on whether the current customer advisory groups of licensed water businesses accurately represent preferences across the customer base and provide a discipline on the business to behave in a way that meets the needs of customers.

Our Community and Customer Advisory Group (CCAG, our equivalent of Sydney Water's Customer Council), includes members representing categories of customers and various organisations, as required by our operating licence:

- business, residential
- organisations representing low income customers, pensioners
- customers living in rural and urban fringe areas, customers with disabilities, customers from culturally and linguistically diverse backgrounds
- local government
- Indigenous Australians.

The operating licence requires Hunter Water to maintain a charter setting out the role of the group, how members are appointed, terms, procedures for communicating outcomes, and a description of the types of matters that may be referred to the group.

Hunter Water's CCAG works well as a stakeholder group in representing various perspectives on a wide range of issues. We make good use of the CCAG in testing views on overall strategy, major projects, and current and emerging issues.

The CCAG does not currently include people with specialist customer engagement or market research skills or experience. We have had difficulty finding and retaining people to represent certain customer categories. We have good attendance from those representing local government, customers living near water catchments and seniors.

We undertook a strategic review of the CCAG in February 2018.¹⁷ This included a workshop to explore ways of ensuring the CCAG meetings and communications are relevant and useful for all members.¹⁸

IPART will shortly commence its 2020-21 end-of-term review of Hunter Water operating licence. At this point in time, Hunter Water has not formed a position on possible changes to the role or composition of the CCAG. We note that the current CCAG serves a range of purposes. Hunter Water always has the option of establishing a separate group to provide guidance and advice.

3.3. What we already know about our customers

In early 2020, Hunter Water undertook an extensive engagement exercise involving 1,200 residential customers using in-depth interviews, an online bulletin board and an online survey. The project looked at 30 service attributes across four service areas, asking customers to rank the relative importance of each and rate their satisfaction with current service levels.

Overall, Hunter Water was seen as a reputable provider of quality services and easy to deal with (see Figure 3.1). The results showed that water supply, wastewater management and customer service are all important to customer satisfaction (see Figure 3.2). These are the areas where our customers rated as most highly.

¹⁷ Some of the challenges were described in IPART, 2018, Review of the Sydney Water Corporation Operating Licence, page 84.

¹⁸ Hunter Water's response to the recommendations arising from the CCAG Strategy Session and proposed timeframe for implementation is available in the Meeting Minutes and Report – May 2018 via <https://yourvoice.hunterwater.com.au/ccag>.

Community and resource management – greenhouse gas emissions, waste management, and wastewater recycling – is of lower importance to overall satisfaction, but also an area of low awareness.

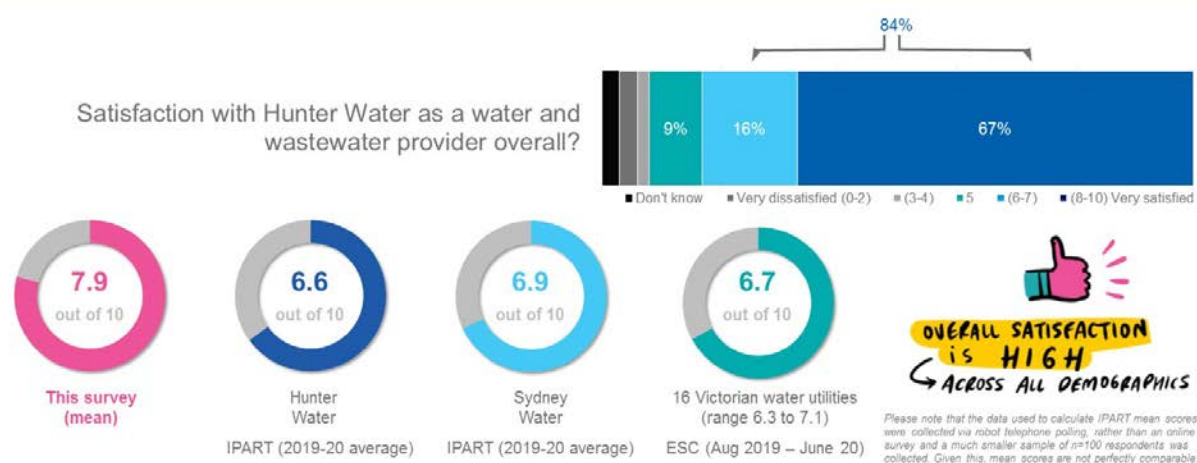
Hunter Water takes some comfort from this survey. It shows a strong foundation in terms of overall levels of customer satisfaction and support amongst residential customers. We know we need to constantly test and respond to customer feedback if we are to maintain and improve these results in the years ahead.

The survey also shows a small proportion of dissatisfied and very dissatisfied customers. We are working to understand the reasons for this response and ways of fixing persistent problems for a small sub-group of customers. We hope to resolve the customer ‘hot spots’ problem in the upcoming licence and price reviews.

Figure 3.1 *Survey findings on overall customer and community satisfaction*

Key findings: More than two thirds (67%) of households are ‘Very Satisfied’ with Hunter Water

Overall only around 5% of customers gave unsatisfied ratings of 4 or less. This translates to a **total mean score of 7.9** (out of a maximum of 10). This is a little higher than the regulator-run customer satisfaction surveys in NSW and VIC. But the difference in survey method and much smaller sample size of the regulators’ surveys mean they are not perfectly comparable.



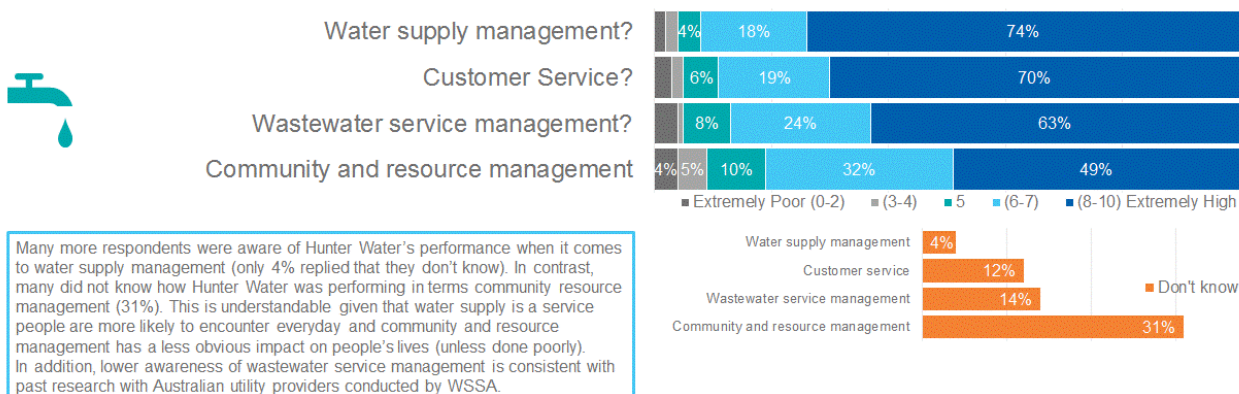
Notes: Survey question 1, How would you rate your satisfaction with Hunter Water as a water and wastewater provider overall? Figures have been rounded so they may not add to 100%. Labels have been suppressed where percentages are less than 3% to aid readability.

Figure 3.2 *Survey findings on customer and community perceptions of Hunter Water's performance.*

Of all the services Hunter Water provide, its water supply management was rated the highest in terms of performance, while community and resource management was rated lowest

This was extremely consistent across the community with no notable differences for any of these services, across all demographics measured. This is important as it suggests that Hunter Water are able to undertake a mass market rather than targeted strategic approach towards improving performance.

% At an overall level how well do you think Hunter Water is performing in terms of...



Notes: Survey questions 6,9,12,15. At an overall level how well do you think Hunter Water is performing in terms of...? All figures have been rounded so they may not add to 100%. Labels have been suppressed where percentages are less than 3% to aid readability.

We acknowledge that IPART's principles-based approach to customer engagement relies on Hunter Water demonstrating the quality of engagement work and how it feeds into business decisions. At this point in time, Hunter Water is considering incremental improvements to the way we do engagement activities and define and measure customer outcomes.

3.4. Workability of a customer forum model

IPART's next price review is scheduled for 2023-24, with the new determination taking effect from 1 July 2024. Hunter Water will submit a pricing proposal to initiate the review on 30 June 2023.

Working backwards, our Board will approve proposed service and expenditure levels in December 2022, and proposed prices in February 2023. This leaves a few months for the internal work in drafting, checking and finalising the proposal.

Hunter Water is planning to complete customer engagement work by July 2022. This will leave sufficient time to understand the insights and findings of the engagement activities, commence project and expenditure prioritisation, and prepare draft outcome statements and metrics.

In order to achieve these timelines, we will need settle on a shortlist of customer engagement topics and methods by the end of 2021, drawing on customer insights work. This will also require internal decisions on the design and delivery of engagement activities to allow for a rollout from January 2022.

IPART will publish a draft report for the current review of the way it regulates water businesses in September 2021 and a final report in January 2022. The mismatch in the timing of reviews calls into question the practicality of establishing new customer representation groups in the near term. It is also implications for the timing of the mid-period check-in.

3.4.1. Good customer engagement takes time

A water business cannot rush good customer engagement work, such as a survey or deliberative forum. A lot of effort goes into the scoping the project, clarifying the objectives, getting internal approvals, engaging specialist support and preparing background material. Executing the activity and collating the results can be done relatively quickly.

Establishing any form of new customer representation model would also take a considerable period of time. There are a lot of steps from the idea stage to the point where the group is making informed and considered judgments. Hunter Water draws on the example of the Negotiation Forum for ESCOSA's determination of SA Water to give a sense of likely timelines.

- 2017 to 2019: SA Water designs and executes various customer engagement activities
- July 2018: ESCOSA announces the establishment of a 3 person Customer Negotiation Forum
- September 2018: Charter and governance document signed by parties
- September 2018 to February 2019: background papers, meetings with stakeholders
- February to June 2019: formal challenge and negotiation at a series of meetings
- November 2019: SA Water submits regulatory proposal, two months late
- December 2019 to February 2020: ESCOSA and Cardno review of expenditure
- March 2020: ESCOSA releases draft determination
- June 2020: ESCOSA makes determination for SA Water to apply from 1 July 2020

ESCOSA announced the establishment of the Customer Negotiation Committee for the review of SA Water's prices in the middle of 2018. The Committee provided advice to ESCOSA 12 months later after considering a range of material provided by SA Water and stakeholders. SA Water gave seven presentations to the Negotiation Committee on a range of matters, including: customer engagement strategy, capital expenditure efficiency and services standards.

An ex-post review of the regulatory process identified a number of problems with the compressed time frame and scope of the exercise: ¹⁹

“Stakeholders generally believed that insufficient time and resources had been available for the Customer Negotiation Committee [CNC] to fully discharge its role, and that genuine negotiation with SA Water did not occur. Greater clarity was needed about the expected outcomes from the Negotiation Forum process. The Consumer Experts Panel also operated under time pressures in the development of its advice.”

“The CNC report also highlighted the lack of time that was available to the CNC to undertake the various tasks assigned to in the Charter, ie ‘to understand SA Water’s strategic directions and priorities, to examine and challenge SA Water’s regulatory proposal and to elicit the views of customers’. The CNC had a period of up to five months to examine and challenge the DBP. The complexity of the task was such that the CNC ‘felt pressured to response to proposals before it had given them adequate time for consideration’. ... There was insufficient time available for the CNC to ‘gain an independent and reliable understanding of the preferences and priorities of SA Water customers.’”

The South Australian experience suggests that a period of 18 months or more would be necessary to do the customer challenge process adequately.

3.4.2. Customer forum model and utility size

Hunter Water observes that regulators and utilities have trialled the full customer forum model in the water and energy sector in only a few instances: SA Water, Scottish Water and Ausnet. These utilities are larger businesses with the capacity and resources to implement and administer this form of engagement.

Hunter Water supplies water and wastewater services to 250,000 customers in a population of around 600,000 people. Hunter Water’s capital program is around \$180 million per annum with annual revenues of around \$340 million. This compares with:

- SA Water: 1.7 million people, \$950 million total annual revenue, and \$450 million annual capital program
- Scottish Water: 5 million people, \$2.5 billion total revenue, and \$1.4 billion annual capital program
- Ausnet electricity distribution business: 1 million people, \$700 million total annual revenue and \$300 million annual capital program.

The customer forum model does not reduce the level of engagement work that the business carries out as part of putting together a regulatory proposal. Rather, it adds another layer to the engagement process. Each utility would still design and commission multiple surveys, deliberative forums, focus groups and the like. The customer forum may also undertake its own customer engagement activities.

Hunter Water has established a working group and a small team to scope, design and perform customer engagement activities over the next 12 months. We would not be in a position to adequately resource another team to implement and support a customer forum model at the same time.

3.4.3. A small group of representatives

Hunter Water is constantly collecting and analysing data on customer demographics, preferences and experiences. Our customer segmentation work provides information within a suburb on typical demographic characteristics for residential and non-residential customers. We do activities like mystery shopping, customer journey mapping, customer trust and satisfaction polling, local events, work with school kids, and various forms of social media. This all helps build a corporate view on the mix of customers and the things that are important.

¹⁹ Patrick Walsh, External post-project review, Stakeholders views regarding the process applied to the SA Water regulatory determination 2020, Report, October 2020, page 2 and 21.

The various customer representation models rely on recruiting and educating a small number of people, typically between 3 and 6 representatives. These people tend to have a background in business, customer engagement work or a relevant part of government, usually outside of the water sector. They must develop an understanding of the regulatory process and building block model as well as learn about the business and the competing investment priorities. After 12 months of papers and presentations from the regulated utility and other stakeholders, they are asked to pass judgments on the merits of long-term business plans, major capital works and associated service levels.

Hunter Water has some concern with a model that relies on a small number of people, chosen by the utility or regulator based on skills or experience, to make judgement and decisions on behalf of a broad range of customer types and demographics.

3.5. Hunter Water's preferred approach

IPART proposes a check-in between the IPART and the utility before detailed work starts on the next pricing proposal. The utility would provide IPART with a customer engagement plan outlining how the various elements of its strategy would deliver a better understanding of customer preferences.

Giving the timing of the next price review, we suggest that this check-in should take place later this year. We anticipate that IPART would provide written advice if it identified material shortcomings in the quality or depth of customer engagement work at that point in time.

Hunter Water agrees with IPART's principles-based approach and commentary about tailoring the approach to suit the utility and its customers. Hunter Water favours an approach that relies on multiple engagement techniques, multiple engagement channels and multiple sources of evidence. This would include stated preference surveys where relevant, including for significant discretionary expenditure proposals.

We are open to the idea of a customer advisory group for our next pricing proposal. We can see merits in various models: a deliberative forum style group, involvement of customer advocates and guidance from industry professionals. We will finalise our approach over the coming months as we develop our customer engagement plan. Our response to IPART's issues paper for the review of Hunter Water's operating licence will comment on the role and functions of the CCAG.

4. INCORPORATING PREFERENCES AND MEASURING OUTCOMES

IPART's proposed focus on customer outcomes represents a new approach to water pricing reviews in New South Wales. If done well, an outcomes approach can have a range of benefits for individual businesses and customers that extend beyond the pricing process, and can help lift the performance of the sector. We note that the introduction of performance commitments and outcome delivery incentives in England and Wales has resulted in a greater focus on customers and material service improvements.²⁰

Hunter Water engaged Aither to provide advice, based on experience in other jurisdictions, on practical considerations that would assist IPART and water businesses in adopting an outcomes-based approach. Aither's advice is provided in Appendix 2 and summarised below.

IPART should promote a clear, consistent and robust approach to developing outcomes, metrics and targets, based on clear terms and definitions and guidance. A clear approach, accompanied by guidance and support, will enable businesses to adopt the new approach more efficiently, support consistency across the sector, support a higher standard in pricing submissions, and ultimately, drive improved outcomes for customers. An example of an outcomes and performance framework, including terms and definitions, is provided in Figure 4.1. The differences between inputs, outputs and outcomes is also shown in Figure 4.2.

Figure 4.1 Example of a simple outcomes and performance framework

ACTIONS	OUTPUTS	OUTCOMES	METRICS & TARGETS
The tasks, projects, services or other things done to deliver outcomes.	<p>The measurable things that result from actions.</p> <p>Outputs capture the things you produce (widgets), but they don't capture change or impact. They are essential, but <i>they can't demonstrate performance against outcomes.</i></p>	<p>The desired change or end state for beneficiaries, considering customers, customer segments, the environment, the business, or other beneficiaries.</p> <p>Outcomes may reflect a change in knowledge, skills, values, behaviour, system operation, or condition or experience.</p>	<p>A metric is a quantifiable measure for tracking performance towards outcomes over time.</p> <p>Targets are the specific desired result for each metric over a defined period.</p>

Source: Aither, 2021.

Outcomes set through the pricing process should focus on the change or end-state for beneficiaries, and reflect the value that a water business provides across its remit and over multiple regulatory periods. In doing so, outcomes provide direction to guide decision-making, prioritisation and planning, and encourage continuous improvement in the way the business delivers its services. Outcomes must also extend beyond traditional engineering and operations themes to include social, cultural, environmental and financial themes. Performance measures should focus on metrics that capture the desired change or end-state for customers, as articulated in the outcomes, rather than actions or outputs.

²⁰ Frontier Economics (UK), 2020, The future of outcome incentives: How we can move to a better approach, page 2.

Figure 4.2 *Example considerations to guide developing outcomes and metrics*

OUTCOME	METRIC
<ul style="list-style-type: none"> Who/what are the beneficiaries? For example: <ul style="list-style-type: none"> Customer, or subset(s) Environment, or subset(s) Community, or subset(s) Business/industry, or subset(s) What is the benefit for them? What is the nature of the change or end-state sought through the outcome? For example, a change in: <ul style="list-style-type: none"> Knowledge or skills? Values or motivation? Behaviour? The way a system or organisation operates? Condition or experience for people, the organisation, environment, or other systems? Can you influence it, and can it respond in your timeframes? 	<ul style="list-style-type: none"> Does the metric capture the type of change articulated in the outcome? Does it reflect the minimum information required to understand progress? Can information be feasibly collected and analysed at an appropriate frequency to measure the desired change? Can results be standardised to allow comparison over time or across regions?

Source: Aither, 2021.

The pricing framework should include common outcomes and metrics, while allowing flexibility for each business to tailor its suite of outcomes and metrics to suit its individual context and customer and business needs. Businesses should select the minimum number of outcomes and metrics that can clearly and specifically articulate the areas of success that are most important to customers and the business.

Businesses will need to undertake customer engagement to inform its outcomes. Effective customer engagement must be strategic. It should be planned and delivered with a focus on a clear purpose for engagement and the level of influence offered to customers (see Figure 4.3). Businesses must demonstrate how customer insights were used to inform the final outcomes and metrics, by clearly linking findings from customer engagement to outcomes and metrics. Businesses should also continue to engage with customers in relation to the pricing submission throughout the regulatory period. This should include gathering data and information against relevant metrics and reporting on performance to customers.

Figure 4.3 *Developing a strategic approach to customer engagement*

Purpose of engagement	<ul style="list-style-type: none"> What are you seeking to achieve through engagement? How do engagement outcomes align with organisation outcomes?
Stakeholders (Who)	<ul style="list-style-type: none"> Who should be engaged in order to fulfil the purpose?
Type of Influence (Why)	<ul style="list-style-type: none"> What input or level of decision-making should stakeholders have?
Engagement Mediums (How)	<ul style="list-style-type: none"> What activities or processes will best enable identified stakeholders to influence?
Timing (When)	<ul style="list-style-type: none"> When should engagement occur? How often? Is there need for continuity among participants?
Briefing Material (What)	<ul style="list-style-type: none"> What information will stakeholders need to ensure effective engagement?

Source: Aither, 2021.

5. DISCRETIONARY EXPENDITURE

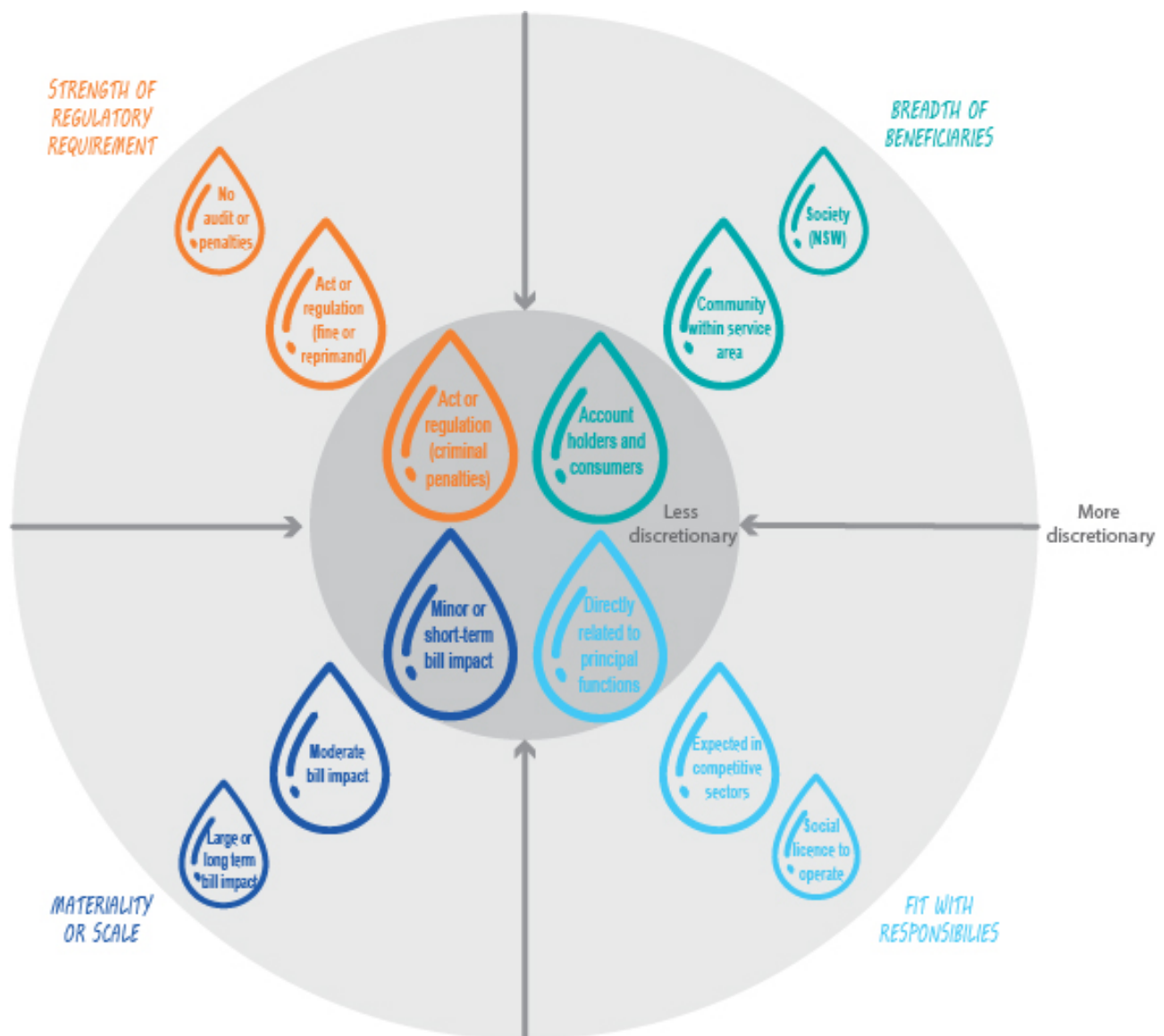
IPART's discretionary expenditure framework was a 'step forward' in that it provided a degree of clarity on the recovery of project cost of activities that go beyond mandated standards.

Where the commentary in IPART's 2016 Final Report accompanying Sydney Water's Price Determination provided too little guidance, the discretionary expenditure framework outlined in IPART's 2020 Final Reports accompanying Hunter Water's and Sydney Water's Price Determination are detailed and prescriptive. The distinction between discretionary recycled water projects and other discretionary projects complicates matters further.

A weakness of the discretionary expenditure framework is that it assumes a crisp delineation between the categories of mandated standards, growth and discretionary projects. In practice, the boundaries often overlap.

The conceptual model in Figure 5.1 shows four dimensions relevant to categorising a water business's activities. Those activities closer to the centre of the diagram readily align with IPART's current guidance on regulatory drivers. We agree that activities towards the edges of the diagram should have face a higher prudence and efficiency hurdle.

Figure 5.1 *Dimensions of activities and expenditure*



Source: Hunter Water.

Hunter Water provides a retail and billing function for 250,000 customer accounts. IPART provides no guidance on how it assesses prudent and efficient investment to maintain and improve these functions. As an example, an online self-service portal that provides a facility for customers to update their contact details, self-manage bills and check usage would be considered discretionary – there is no explicit legislative or regulatory requirement to provide this specific service.

We would welcome an IPART statement on the way it assesses investment in digital services to support the retail function. IPART could reference customer expectations of modern retail services by commercial utilities, such as telecommunications. This expenditure should not default to the discretionary expenditure framework and the obligation undertake an economic willingness to pay study.

Overall, Hunter Water would like to see greater integration of the mandatory and discretionary expenditure frameworks for the majority of expenditure proposals, particularly where the pricing proposal is based on a suite of customers outcomes that set out 'what you get for what you pay'.

APPENDIX 1 RESPONSES TO IPART QUESTIONS

The businesses should be responsible for understanding customer preferences



IPART sought feedback on:

1. Should we require a customer engagement plan to be submitted in the lead-up to a pricing proposal? How far in advance of the proposal due date should it be submitted? Should this be published?



A regulatory 'check-in' between IPART and water businesses would be consistent a regulatory model that encourages open and transparent communication and mutual acknowledgment that performance of the sector is best lifted through cooperation.

To be of most value, IPART would provide a clear, preliminary view on the customer engagement plan. It would diverge from past practice in which feedback has been provided *ex post* on specific deficiencies in customer consultation. Instead it would encourage genuine improvement and take a solution-oriented approach to co-resolution of problems.

Once established, we suggest:

- checking-in on the customer engagement plan two years prior to water businesses lodging their pricing proposals. This timing would provide around one year to implement the main elements of the engagement plan.
- checking-in again – less formally – around one year prior to lodgement of proposals, when water businesses are using the feedback from customer engagement to formulate and prioritise activities and associated expenditure.

We are aiming to undertake most of the customer engagement for our next pricing review between now and July 2022. We suggest a check-in with IPART towards the end of this year or early 2022.



IPART sought feedback on:

2. Should we move to a system of grading the quality of proposals?

We support moving to a system of grading the quality of proposals.



Appealing features include:

- reinforcing the non-binary nature of customer engagement and pricing proposal quality
- providing tangible examples of higher-quality customer engagement and pricing proposal for water businesses to work towards
- acknowledging, and encouraging, genuine and effective improvements rather than 'business-as-usual'.

Challenges that may need to be overcome include:

- scaling expectations at each performance level for the scope and size of the water business
- developing clear principles and grading criteria for assessing how well a business's pricing proposal performs in promoting the long-term interests of customer.

Hunter Water's preference is to link the grading with reputational and procedural incentives.

The guidance that IPART provides



IPART sought feedback on:

3. Are our customer engagement principles current and fit for purpose? How could they be improved?



Hunter Water supports adoption of a principles-based approach to determining the acceptability of customer engagement activities. The current principles for effective engagement provide the regulator with confidence in the information received. However, they could be improved to:

- reflect emerging trends in best practice engagement methods, such as a range of techniques being used throughout engagement programs, the expectation of universal and inclusive engagement, and a greater emphasis on triangulation and iteration
- acknowledge and address difficulty in achieving ‘representativeness’, including statistically significant sample sizes, for some customer segments and in some localities
- provide clear and early guidance on request to water businesses that genuinely seek to comply with the principles but encounter a hurdle.

We fully support IPART’s comment in the Discussion Paper:²¹

Success requires a credible commitment from the business and regulator and open and transparent communication. It also requires an acknowledgement that there may be room for improvement and the journey should be taken together.



IPART sought feedback on:

4. Do you agree with our additional 3 principles relating to incorporating customer preferences and performance? Is something missing?



We support expanding the principles to reinforce the expectation that customer insights are appropriately considered in business decision-making and businesses are held accountable through trackable, transparently-reported outcome measures.

Customer advisory or negotiation groups



IPART sought feedback on:

5. How fit for purpose are the current customer advisory groups? How could they be enhanced?



Hunter Water’s current Customer and Community Advisory Group (CCAG) serves a range of purposes.

IPART will shortly commence its 2020-21 end-of-term review of Hunter Water operating licence. At this point in time, Hunter Water has not formed a firm position on whether the operating licence should mandate changes to the role or composition of the CCAG.

²¹ IPART, 2021, Promoting a customer focus: Discussion Paper, Special Review, June, page 9.



IPART sought feedback on:

6. Is there a need for a subsidiary customer advisory group developed with expert skills to represent customers?



Water business may establish a specialist group to provide expert guidance and advice on best practice customer research and engagement methods. There are several options for placement of such a group within organisational governance structures. Each business is best placed to assess the suitability of such a group for their circumstances.



IPART sought feedback on:

7. Should non-licensed utilities adopt a form of customer advisory panel? Why or why not? How would this be run and funded?



This is a matter for non-licensed utilities.

Incorporating preferences and measuring outcomes



IPART sought feedback on:

8. Do you agree we should be tracking outcomes? What kind of outcomes should we track? Would these vary by business?



We support a framework that links expenditure, outputs and outcomes with customer values and preferences. Delivering value for money for customers requires a close relationship between outcomes and prices, to ensure outcomes reflect customer priorities and the scope for beneficial trade-offs.

We agree with IPART that performance assessment should focus on outcomes rather than inputs. This is required to ensure the outcomes and level of services customers want are identified, understood and delivered.

Discretionary expenditure



IPART sought feedback on:

9. Is the discretionary expenditure framework fit for purpose?



The discretionary expenditure framework was a 'step forward' in that it provided a degree of clarity on the what it would take for IPART to consider recovering the cost of activities that exceed mandated standards. Where the commentary in IPART's 2016 Final Report accompanying Sydney Water's Price Determination provided too little guidance, the discretionary expenditure framework outlined in IPART's 2020 Final Reports accompanying Hunter Water's and Sydney Water's Price Determination are too prescriptive and impractical.



IPART sought feedback on:

10. Should this framework be retained separate to a framework for mandatory services?



We support greater integration of the mandatory and discretionary expenditure frameworks for the majority of expenditure proposals, particularly where the pricing proposal is based on a suite of outcomes defined with customers in an overall price-service offering. There may be limited circumstances where it may be appropriate to have a higher hurdle to achieve funding through regulated periodic prices, such as those with material, long-term bill impacts that have a weak nexus with water businesses primary functions and/or beneficiaries beyond the water business's region.

If retained, the discretionary expenditure framework should be reviewed for clarity and practicality through a consultative process with stakeholders.

APPENDIX 2 AITHER'S ADVICE ON SETTING AND TRACKING OUTCOMES

Memorandum – Final

Input to response to IPART paper: Promoting a Customer Focus

To: Emma Turner, Peter Shields

From: Clare Ferguson, Tim Ryan

Date: Tuesday 20 July 2021

Summary

The Independent Pricing and Regulatory Tribunal (IPART) is calling for submissions in response to its recently released *Promoting a Customer Focus Discussion Paper*. The paper includes a discussion question on whether outcomes should be tracked, what kinds of outcomes should be tracked, and whether outcomes would vary by business.

IPART's proposed focus on customer outcomes represents a new approach to pricing reviews and proposals in New South Wales (NSW). If done well, an outcomes approach can have a range of benefits for individual businesses and customers that extend beyond the pricing process, and can help lift the performance of the sector. IPART should promote a clear, consistent and robust approach to developing outcomes, metrics and targets, based on clear terms and definitions and guidance. A clear approach, accompanied by guidance and support, will enable businesses to adopt the new approach more efficiently, support consistency across the sector, support a higher standard in pricing submissions, and ultimately, drive improved outcomes for customers across NSW.

Outcomes set through the pricing process should focus on the change or end-state for beneficiaries, and reflect the value that a water business provides across its remit and over multiple regulatory periods. In doing so, outcomes provide direction to guide decision-making, prioritisation and planning, and encourage continuous improvement in the way the business delivers its services. Outcomes must also extend beyond traditional engineering and operations themes to include social, cultural, environmental and financial themes. Performance measures should focus on metrics that capture the desired change or end-state for customers, as articulated in the outcomes, rather than actions or outputs.

The pricing framework should include common outcomes and metrics, while allowing flexibility for each business to tailor its suite of outcomes and metrics to suit its individual context and customer and business needs. Businesses should select the minimum number of outcomes and metrics that can clearly and specifically articulate the areas of success that are most important to customers and the business.

Businesses will need to undertake customer engagement to inform its outcomes. Effective customer engagement must be strategic. It should be planned and delivered with a focus on a clear purpose for engagement and the level of influence offered to customers. Businesses must demonstrate how customer insights were used to inform the final outcomes and metrics, by clearly linking findings from customer engagement to outcomes and metrics. Businesses should also continue to engage with customers in relation to the pricing submission throughout the regulatory period. This should include gathering data and information against relevant metrics and reporting on performance to customers.

Background and context

The Independent Pricing and Regulatory Tribunal (IPART) is calling for submissions in response to its recently released *Promoting a Customer Focus Discussion Paper*. This memorandum will assist Hunter Water in preparing its response to the following discussion question:

Do you agree we should be tracking outcomes? What kind of outcomes should we track? Would these vary by business?

In this memorandum, we have outlined our advice in relation to:

- The benefits of focussing on outcomes
- Designing outcomes and metrics
- The kinds of outcomes to track
- Common and varied outcomes and metrics
- The appropriate number of outcomes and metrics
- Using customer insights
- Consideration of discretionary expenditure framework

Our advice draws on our experience working with government agencies, particularly in the Australian water and environment sectors, to develop and implement outcomes and performance frameworks. It also draws on our insights from Victoria's implementation of the Essential Services Commission's (ESC) [PREMO water pricing framework \(PREMO\)](#). PREMO came into effect in July 2018, and Victorian water businesses are now beginning to prepare their second pricing submission using the framework. This provides NSW with an opportunity to learn from the first years of Victoria's adoption of an outcomes-focused pricing framework.

The benefits of focussing on outcomes

IPART's proposed focus on customer outcomes represents a new approach to pricing reviews and proposals in NSW. If done well, an outcomes approach can have a range of benefits for individual businesses beyond the pricing process, and can help lift the performance of the sector. These include:

- creating clarity and improved alignment among staff, promoting a shared understanding of the customer's expectations.
- strengthening the line of sight for staff to connect their day-to-day work with the customer outcomes.
- promoting learning, adapting and continuous improvement, by developing and testing a logic of change for achieving customer outcomes and generating insights into where effort is creating greatest benefit for customers.
- driving continuous improvement through adoption of targets, supported by more meaningful and regular measurement of progress against customer outcomes.
- reporting on progress and successes, demonstrating the value provided by each business and the sector to customers, IPART and other government stakeholders.

IPART should promote a clear, consistent and robust approach to developing outcomes, metrics and targets. This will enable water businesses to adopt the new approach efficiently, effectively and to the

best of their ability. This includes setting clear expectations and guidance for water businesses to develop appropriate outcomes and metrics that will:

- Be meaningful for the customer and the business,
- Promote continuous improvement in delivering value for customers and stakeholders,
- Be practical to deliver and assess performance against, and
- Enable an understanding of sector-wide performance.

A clear approach, accompanied by guidance and support, will enable businesses to adopt the new approach more efficiently, support consistency across the sector, support a higher standard in pricing submissions, and ultimately, drive improved outcomes for customers.

Designing outcomes and metrics

IPART's guidance should be based on clear terms and definitions, provide direction for developing outcomes, metrics and targets, and be accompanied by other training and support for business to adopt the new approach.

Start with clear terms and definitions to promote efficiency, consistency and quality

Designing appropriate outcomes and metrics starts with a simple conceptual framework that sets out clear terms and definitions. There are various approaches used for designing outcomes and metrics, and there are often variations in terminology and how terms are applied both within individual businesses and across a sector. These variations can lead to confusion, inconsistency, and misuse of terms and concepts. This can ultimately result in poorly defined outcomes and metrics, difficulties measuring and communicating performance, and challenges for establishing an understanding of sector-wide performance. These issues can be avoided from the outset if there is a clear and consistent approach to designing outcomes and metrics, based on a simple and practical conceptual framework with clearly defined terminology.

The conceptual framework must set out the components required for articulating what success looks like and how progress and success will be measured over time. It should include clear terms and definitions that enable businesses to apply the concepts appropriately, consistently and in alignment with IPART's expectations. It must distinguish between those terms and concepts that are often confused and misused, for example "outputs" and "outcomes". An example of terms and definitions that could form the basis of a performance framework is provided below (Figure 1).

ACTIONS	OUTPUTS	OUTCOMES	METRICS & TARGETS
The tasks, projects, services or other things done to deliver outcomes.	The measurable things that result from actions. Outputs capture the things you produce (widgets), but they don't capture change or impact. They are essential, but <i>they can't demonstrate performance against outcomes.</i>	The desired change or end state for beneficiaries, considering customers, customer segments, the environment, the business, or other beneficiaries. Outcomes may reflect a change in knowledge, skills, values, behaviour, system operation, or condition or experience.	A metric is a quantifiable measure for tracking performance towards outcomes over time. Targets are the specific desired result for each metric over a defined period.

Figure 1 Example of a simple outcomes and performance framework, including terms and definitions

Designing appropriate outcomes

In our experience, businesses and government agencies tend to focus on identifying actions and outputs but find defining outcomes and metrics more challenging. As shown in Figure 1, outcomes should articulate the desired change or end state for customers or other beneficiaries, not actions or outputs. In Victoria, several water businesses adopted "outcomes" that reflected an action, output or principle, rather than a change or end state. For example, one Victorian business adopted an outcome of "be responsive and willing to adapt as [customer] needs change". In this example, the business in question should rearticulate the statement to reflect what it means for the customer when the business is responsive and willing to adapt. By focusing on the change or end state (which, in this case may reflect the customer experience) for customers, outcomes should clearly articulate the value or benefits that the business provides.

By focusing on the desired change or end state, outcomes provide direction to guide decision-making, prioritisation and planning, and encourage continuous improvement in the way the business delivers its services. To achieve this, outcomes should also:

- Reflect the remit of the business,
- Align with higher-level strategies (such as the NSW Water Strategy and relevant regional or metropolitan water strategy),
- Reflect customer needs, and
- Be appropriate to timeframes.

The questions below may assist water business to articulate appropriate outcomes and practical metrics (Figure 2). Outcomes and metrics should be considered as a collective suite. There will be interrelationships between some outcomes, with success in one area supporting success in another. Water businesses can also expect that individual actions or activities will contribute to more than one outcome.

OUTCOME	METRIC
<ul style="list-style-type: none"> • Who/what are the beneficiaries? For example: <ul style="list-style-type: none"> • Customer, or subset(s) • Environment, or subset(s) • Community, or subset(s) • Business/industry, or subset(s) • What is the benefit for them? • What is the nature of the change or end-state sought through the outcome? For example, a change in: <ul style="list-style-type: none"> • Knowledge or skills? • Values or motivation? • Behaviour? • The way a system or organisation operates? • Condition or experience for people, the organisation, environment, or other systems? • Can you influence it, and can it respond in your timeframes? 	<ul style="list-style-type: none"> • Does the metric capture the type of change articulated in the outcome? • Does it reflect the minimum information required to understand progress? • Can information be feasibly collected and analysed at an appropriate frequency to measure the desired change? • Can results be standardised to allow comparison over time or across regions?

Figure 2 Example considerations to guide developing outcomes and metrics

Identifying practical and meaningful metrics and targets

Identifying metrics for measuring performance against outcomes was a challenge for most businesses in Victoria. The PREMO framework requires businesses to identify "the measurable outputs and deliverables and associated targets that will demonstrate achievement of each outcome". As such, many businesses used completion of actions and outputs to measure performance. Measuring outputs is useful for understanding what a business has done, but it does not reveal much about the value that the business provides customers. Instead, performance measures should focus on metrics that reflect the desired change or end state for customers, as articulated in the outcomes. Ensuring that metrics focus on measuring outcomes, rather than actions or outputs, has a range of benefits that extend beyond pricing submissions and reporting, including:

- allowing flexibility to identify the most appropriate suite of actions and outputs, and to adjust actions and outputs over time if needed to ensure or enhance success or to enhance efficiency,
- creating space for finding alternative, and potentially innovative, ways to achieve outcomes more effectively and efficiently, and
- providing delivery staff with more autonomy to plan and refine their activities to achieve outcomes, giving them greater ownership of the results.

Water businesses are already required to report on performance through a range of processes. This may include reporting against licence conditions, National Performance Reporting, and internal business reporting. Some of the data or information that is already (or expected to be) collected and reported through these processes may be relevant for measuring performance against outcomes in the pricing framework. For efficiency, IPART and the water businesses should draw on existing data collection processes, where relevant, for measuring performance against outcomes in the pricing framework. However, businesses will need to ensure that they only draw on existing processes if the data or information is fit-for-purpose for the pricing framework. Data sources must be selected on the basis that they align with the outcomes, rather than having data availability drive the outcomes or metrics. Water businesses should be prepared to introduce new, or expand or modify existing, data collection processes to measure performance against its outcomes. The considerations outlined in Figure 2 may be used to guide decisions regarding identifying metrics and appropriate data sources or collection processes.

Setting targets against metrics, where appropriate, helps to encourage improvement and set the standard for success. Yet it can be difficult to find the balance between setting a target that is easily achievable, and a target that is more aspirational. A target that is easily achievable presents low risk for the water business but is unlikely to encourage improvement in performance, while an aspirational target is likely to drive performance improvement but presents the risk of failure to meet the target even if there is noticeable improvement towards the target.

Water businesses are required to meet minimum performance standards set out in their operating licence. The pricing framework should promote optimisation (where appropriate) in meeting minimum requirements and promote continuous improvement and value-add to customers through outcomes and metrics. The pricing framework could support a combination of performance metrics that reflect:

- obligations or minimum standards, such as water quality standards, but have opportunity to improve efficiency in maintaining those standards.
- enhanced value for customers, such as timely communication and responses to customer enquiries or improved efficiencies in achieving minimum standards, where more ambitious targets may appropriate.

The pricing framework should reward businesses that set targets that will drive improvement. The pricing framework needs to allow for water businesses to provide an explanation of the basis of its targets, including why the business considers the target to be appropriate. Water businesses also need reassurance that they will not be penalised for failing to meet an ambitious target, if they can demonstrate that the failure was not from lack of trying. Overall, the framework should encourage businesses to provide a narrative against outcome and metric performance, including commentary on anything that may have helped or hindered success, and other information to support quantitative results against metrics, including case studies and qualitative insights.

The business will need to understand the cost-service trade-offs that it can deliver for customers when identifying suitable targets. This requires a detailed knowledge of network operations so the business can understand where services can be improved with little cost impact, and where service improvements will require considerable investment. In some cases, businesses may need to invest in the network to simply maintain the current levels of service for customers. This may be due to legacy infrastructure, or capacity constraints in the network. In these cases, it may be appropriate to set a stretch target. Instead, the business could adopt a target that maintains the current levels of performance while minimising cost increases. Understanding cost-service trade-offs will be important to inform business investment decisions and for customers to provide an informed opinion on the potential outcomes and their associated metrics and targets.

Provide guidance and support for developing and tracking outcomes for the pricing framework

Adopting customer-focused outcomes in the pricing framework is a new and different approach for IPART and the NSW water businesses. It introduces drawing on customer input to inform (or influence) decision-making; target-setting and accountability to promote continuous improvement, and; the potential need for trade-offs and prioritisation to meet customer outcomes. In Victoria, the ESC recognised the shift required to adopt the new approach presented by PREMO through leniency in its assessment of outcomes and performance measures. The ESC accepted the proposed outcomes and performance measures even when outcomes and measures could have been better defined. This leniency sought to support businesses in adopting the new approach, and recognised that improvements could be made over time. The ESC also emphasises that the PREMO approach is intended to allow flexibility for businesses to apply the framework in a way that suits them. However, this flexibility was a challenge, with many businesses wanting clearer guidance or direction. Overall, the quality and practicality of outcomes and metrics varied among Victorian businesses, despite the good intentions of many of the businesses in adopting the PREMO approach.

It will be important for IPART to acknowledge the changes that the new approach will require of the water businesses and of IPART itself, and to establish appropriate change management support. This includes (but is not limited to):

- Ensuring that IPART has access to the right skills and resources to:
 - lead the change,
 - support businesses to make the change,
 - to assess outcomes, metrics and targets in the pricing submissions, and
 - identify opportunities and build support for refinements and continuous improvement in adopting the change,
- Providing clear written guidance to water businesses on how to apply the new approach, and

- Offering training or other support to businesses wishing to better understand or to build capability to apply the new approach.

IPART should provide guidance and support that sets clear expectations for developing and documenting outcomes and metrics, including the standards expected in relation to quality, detail and consistency, while also allowing appropriate flexibility to apply the framework to suit businesses' specific circumstances. Guidance should include:

- Clear terms and definitions,
- Considerations for developing each component (outcomes, metrics, targets, actions and outputs),
- Requirements for adopting common outcomes and metrics and opportunities for developing business-specific outcomes and metrics, if and where relevant,
- A clear rubric (assessment criteria and scoring guide) to guide consistent and transparent self-assessment by water businesses,
- Expectations for customer engagement to inform the development of outcomes and metrics, and measuring progress, where relevant, and
- Expectations for documenting each component in the pricing submission.

Outcomes should be tracked across a variety of themes

Businesses should track outcomes that reflect the matters that are most important to customers and the business. Outcomes should focus on the change or end state for beneficiaries, reflect the value that a water business provides across its remit, and reflect the change or impact sought over multiple regulatory periods. Outcomes must also extend beyond traditional engineering and operations themes to include social, cultural, environmental and financial themes. Examples of outcome themes or topics for NSW water businesses include:

- **Infrastructure and network performance:** water supply and wastewater treatment system efficiency, disruptions.
- **Service delivery:** short-term and long-term reliability, water quality or safety, aesthetics, customer service.
- **Environmental performance or impact:** water efficiency, greenhouse gas emissions, waste, resource recovery and reuse. The environment may be considered a proxy for future customers.
- **Social and cultural:** affordability, supporting disadvantaged customers, supporting local employment, supporting employment and training for disadvantaged people, contribution to community, social licence to operate.

The identification of outcome(s) within these themes will need to reflect those topics that are most important to customers, the business and other stakeholders, including cascading from NSW Water Strategy, relevant regional or metropolitan water strategy, and state or regional plans.

Outcomes must also be appropriate to agreed timeframes. IPART will need to provide guidance on timeframes for outcomes. In Victoria, the ESC expects that each business's outcomes will remain largely consistent over regulatory periods. Setting outcomes that extend over multiple regulatory periods can account for longer lag times between undertaking an action and realising the outcome. They also encourage longer-term, strategic planning, which supports overall business efficiency and performance and is in the long-term interests of customers.

Yet some important or foundational outcomes can also be achieved within a shorter timeframe, and there can be benefit in articulating, measuring and reporting against these to provide confidence that the business is making progress towards longer-term outcomes. The kinds of changes that outcomes typically reflect for different timescales include:

- Short-term: knowledge, skills, values or motivation.
- Medium- to long-term: behaviour, system or organisation operation, condition or experience.

The pricing framework should require water businesses to identify outcomes that extend across regulatory periods, while allowing the flexibility to reflect change in the short-term through:

- Identifying a small number of short-term outcomes, applicable to the immediate regulatory period and are foundational or aligned with longer-term outcomes, or
- Reflect different timeframes in setting targets against metrics, including different rates of change that may be applicable to different timeframes.

Pricing submissions should combine common and varied outcomes and metrics

The pricing framework should include common outcomes and metrics, while allowing the flexibility for each business to tailor its suite of outcomes and metrics to suit its individual context and customer and business needs.

Water businesses have many common obligations, remit and services but may differ in terms of scale and scope (vertical integration or disaggregation). As shown in the previous section, there will also be common outcome themes or topics that cover these shared business activities. In Victoria, there were common outcome themes across many businesses' pricing submissions. In a sample of ten Victorian water businesses, eight had outcomes relating to each of the following themes: potable water quality, service reliability, customer service experience, and affordability. There are limits to the ways in which outcomes can be articulated in relation to these themes, and often different articulations will share the same intent. Therefore, there is benefit in developing common outcomes and metrics (but differing targets) for common themes. This would help to:

- Simplify the process for businesses,
- Ensure outcomes and metrics are defined appropriately for these common themes, and provide examples to guide businesses to do the same for other themes,
- Ensure alignment with relevant legislation and higher-level strategies and plans,
- Allow more meaningful reporting of sector performance by enabling reporting against sector-wide outcomes and metrics (while taking care to avoid direct comparisons between businesses given differing scales, scopes and operating contexts), and
- Promote sector performance by supporting knowledge sharing and collaboration in working towards common outcomes.

However, there also needs to be flexibility for businesses to tailor their overall suite of outcomes and metrics to suit their unique needs. This should include the flexibility to:

- Opt out of any common outcomes, if the business can justify why the outcome in question is not relevant to the business or is less valued by its customers.
- Identify additional outcomes that are tailored or unique and considered important to the business and its customers.

- Select metrics from a common list that are most appropriate and practical for the business, and identify any additional metrics, if required to fill any gaps or appropriately tailor to the business.
- Set targets that are appropriate to the business (aside from meeting compliance or other obligations).

Minimise the number of outcomes and metrics selected

There is no "right" number of outcomes for water businesses. Instead, each business will need to identify a suite of outcomes and metrics that balances:

- Capturing the breadth of the value that the business provides to customers,
- Driving performance, where appropriate, and
- Practicality for guiding planning and delivery, and for measuring performance.

The number of outcomes and metrics will also be driven by the level of detail in the outcomes. Collectively, an outcome and its metric(s) will need to be specific. If outcomes are high-level, then metrics will need to be more specific. In this case, a water business is likely to have fewer outcomes with more metrics identified for each outcome. If outcomes are more specific, then the suite is likely to comprise of more outcomes with fewer metrics against each. There are advantages and disadvantages for either approach. Keep in mind that:

- The number of metrics for an outcome does not reflect the relative importance of the outcome.
- A smaller set of outcomes can be easier for staff to remember, and therefore apply through their planning and delivery.
- Higher-level outcomes can risk being vague. Therefore, care should be taken to ensure that high-level outcomes are crafted to be clear and meaningful, and further clarified through specific and time-bound metrics and targets.
- Outcomes that are too specific can constrain flexibility, efficiency and adaptive management in delivery.

Businesses should select the minimum number of outcomes and metrics that can clearly and specifically articulate the areas of success that are most important to customers and the business.

Using customer insights to develop pricing submissions

Water businesses will need to understand what is important to customers to enable them to define and deliver customer outcomes. Therefore, businesses will need to undertake some level of customer engagement to inform its outcomes.

Effective customer engagement will need to be strategic. It should be planned and delivered with a focus on a clear purpose for engagement and level of influence offered to customers. An example process for developing a strategic approach to customer engagement is provided below (Figure 3).

Purpose of engagement	<ul style="list-style-type: none"> • What are you seeking to achieve through engagement? • How do engagement outcomes align with organisation outcomes?
Stakeholders (Who)	<ul style="list-style-type: none"> • Who should be engaged in order to fulfil the purpose?
Type of Influence (Why)	<ul style="list-style-type: none"> • What input or level of decision-making should stakeholders have?
Engagement Mediums (How)	<ul style="list-style-type: none"> • What activities or processes will best enable identified stakeholders to influence?
Timing (When)	<ul style="list-style-type: none"> • When should engagement occur? How often? • Is there need for continuity among participants?
Briefing Material (What)	<ul style="list-style-type: none"> • What information will stakeholders need to ensure effective engagement?

Figure 3 Developing a strategic approach to customer engagement

The level of influence offered to customers will be critical in designing the engagement process. There are standards available to guide the selection of the level of influence, such as the IAP2 Spectrum for Public Participation or the Continuum of Joint Effort. If recommending an existing spectrum, IPART should also provide guidance on how to apply the spectrum in the context of customer engagement for the pricing submissions. Alternatively, it may be more useful to provide a simplified guide for the pricing framework. This could reflect:

- Low influence - engagement is about understanding customer needs/preferences.
- Medium influence - customers influence outcomes and metrics, with input to targets.
- High influence - customers decide on outcomes, metrics, targets, and penalties.

The costs of undertaking engagement and risks to the water business based on the results of that process will vary depending on the level of influence. Each business will need to consider the costs and risks when identifying the level of influence that it will offer to customers.

Water businesses should identify engagement processes to suit the engagement purpose and level of influence offered to customers (or representatives). A survey is a useful and repeatable way to capture input from a broad group of customers. However, there are other complementary techniques that can be used for seeking customer input to and validation of outcomes and metrics. These can include:

- Focus groups
- Interviews
- Citizens Jury/Consultative Committee
- Town hall sessions
- Social media
- Stalls at community events

IPART should provide guidance on the level of influence and the kinds of engagement techniques that it will consider to be appropriate for the pricing framework. In developing its guidance, IPART should consider the ways in which the customer typically engages with a water utility, and the costs and risks associated with different approaches. In Victoria, many businesses found that customers generally only thought about their water utility when paying a bill or when something went wrong. There was often misunderstanding of the role and responsibilities of the water business, and the challenges and trade-offs that water businesses often must navigate. For some businesses, this led to the adoption of penalties that may have perverse implications for service delivery for another customer or in another

area of the business. To manage these issues, water businesses must either offer a level of influence to customers that reflects customer capacity to appropriately participate, or spend time building the customers' capacity to meaningfully contribute towards decision-making.

Regardless of the chosen approach to customer engagement, it will be important that each water business can demonstrate how customer insights were used to inform the final outcomes and metrics. Reporting on customer engagement should include both a summary of the process and the findings, including how findings were developed and validated with customers during different stages in the process. Findings from customer engagement should be clearly linked to the final outcomes and metrics. Ideally, this would include a summary of findings from customer engagement mapped to each relevant outcome. Some examples used by Victorian water businesses included:

- Short statements of "what our customers said" or customer quotes in relation to each outcome,
- A summary "engagement finding" against each outcome,
- A separate summary of how customer insights informed the outcomes overall.

Water businesses should continue to engage with customers in relation to the pricing submission throughout the regulatory period. This should include gathering data and information against certain types of metrics to:

- identify baselines,
- inform suitable targets, and
- track performance over time.

Businesses should also report on performance to customers. Reporting to customers should be accessible and meaningful for customers, and be undertaken periodically during the regulator period at a frequency suitable for identifying change in performance.

Consideration of discretionary expenditure framework

IPART recently introduced a discretionary expenditure framework that was designed to emphasise the importance of customer willingness to pay in utility pricing submissions. IPART noted that there are two categories of costs for utilities:

- complying with mandatory obligations, and
- undertaking discretionary projects.

In its most recent price reviews, IPART committed to reviewing and refining elements of its discretionary expenditure framework. The broader framework review of the way that IPART regulates water utilities will further necessitate a review of its discretionary expenditure framework to ensure it remains relevant for utilities.

If IPART were to adopt an approach to regulation that focuses on delivering outcomes for customers, this outcomes-based approach can be used to determine the discretionary projects that customers are willing to pay for. Utilising customer engagement to define outcomes and identify projects that go beyond mandatory obligations that customers are willing to pay for would likely form a key component in such a framework. The detail of any such framework will be important to ensure that any mechanism does not create perverse outcomes. These considerations are consistent with the intent of IPART's discretionary expenditure framework.

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